Strategic Issues in Infrastructure and Trade Policy

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Abstract

This paper was prepared for the HIID-World Bank retreat “Strategic Issues in African Development”, Washington D.C., 7th-8th January, 1999. It discusses the strategic issues of infrastructure and trade policy as dimensions of restarting and sustaining growth and development in Africa.

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1. Introduction

Neither infrastructure nor trade policy is an end in itself. Both are dimensions of the objective of restarting and sustaining growth and development in Africa. This is clear from the WDR 1994 whose theme is “infrastructure *for* development”[1]. And, as Rodrik (1997) noted, trade policy is one component of a broader effort to promote growth in Africa.

The strategic issues for infrastructure are:

- Is the program outlined in WDR 1994 relevant for sustained growth and development in Africa?
- If not, how should it be modified? If so, how can the program be implemented?

For trade policy:

- What changes in trade policy will help stimulate and sustain growth and development in Africa?
- What is required for African governments to move away from their present focus on “aid not trade” to an approach based on “trade not aid”?

For the two together:

- What links between trade policy and infrastructure will help sustain growth and development in Africa?

This chapter examines these issues. Section 2 has background. Section 3 discusses infrastructure. Section 4 deals with trade policy. Section 5 considers the connections between infrastructure and trade policy. Section 6 has concluding comments.

2. Background

There is now a large literature on Africa’s economic performance over the last three decades (Sachs and Warner 1995; Collier and Gunning 1997; Block 1998; Freeman and Lindauer 1998). Words such as “poor,” “dismal,” and expressions such as “lost decades” are common. Caveats and qualifications are noted (e.g., Mauritius and Botswana). From the early 1990s, a modest recovery was evident (Madavo and Sarbib 1997; Wolfehnson 1997; IMF 1997). However, this has been cut short by spillovers from Asia’s economic difficulties, resurgent war (Sierra Leone, Ethiopia/Eritrea, and Angola being the most recent), and internal politics (Zimbabwe).

Despite all the attention on African economic performance, few studies highlight what is needed to move African governments away from the (almost) universal pattern of start-stop reform. Indeed, with the exception of Mauritius, no African country has adopted a structural adjustment program and stuck to it. The literature has many explanations why reform has been abandoned or deflected – political, economic, game-theoretic, and institutional. No African country has gained (in terms of growth or development) by not reforming. Why, then, has this behavior has been so prevalent? One sees many references to “ownership,” “political will,” and (recently) “leadership.” These, however, simply push the problem back one level, making it no easier to understand what determines these factors.

What would be required to induce African governments to break the pattern of start-stop reform? How can growth and development be accelerated and sustained once this pattern has been broken?

Development specialists have identified many factors that might be important for long-term growth and development across Africa and literally dozens of new initiatives have been taken. Many more are likely in the future. There has been no lack of effort[2]. What has been lacking, it seems, is a willingness to simplify what is expected of African governments. Most developed countries could not (and would not) attempt to implement the types of structural adjustment programs that have been formulated for African governments.[3] Despite a history of indifferent adjustment performance,[4] the expectations by donors of what can be achieved have been ratcheted up. It is little wonder that adjustment programs fail so regularly.

Simplifying the adjustment programs will not necessarily make them easier. What it will do, however, is allow (or require) African governments to focus their efforts on the few strategic areas that will lay a foundation by which growth, once started, can be sustained. The need for concentrated effort has become more critical over the last few years.[5] HIV/AIDS has dramatically accelerated the institutional erosion that was already well advanced due to years of economic decline (Hoover and McPherson 1999). Stabilizing these institutions in ways that will permit growth and development to proceed is a strategic issue beyond the scope of this chapter. I raise it here as a reminder that policies related to infrastructure and trade have to be consistent with both institutional and human capacities, both of which have been under stress.

3. Strategic Issues in Infrastructure

The 1994 WDR noted:

> Infrastructure is no longer the gray backdrop of economic life – underground and out of mind. It is front and center in development (p. 12).

Even if this were the case in 1994, does that emphasis still apply? It is worth recalling that infrastructure moved “front and center” against a background of initiatives on poverty (WDR 1990), environment (WDR 1992), and health (WDR 1993). And since 1994, “front and center” has been shared with the problem of workers in an international setting (WDR 1995), moving countries from plans to markets (WDR 1996), inducing the state to adapt (WDR 1997), and using knowledge to promote development (WDR 1998). Each year the focus shifts.

What, we might ask, remains special about infrastructure? What is left of the 1994 agenda?

The basic conclusions of WDR 1994 were:

- Manage infrastructure like a business, not a bureaucracy

- Introduce competition – directly if possible, indirectly if not.
- Give users and other stakeholders a strong voice and real responsibility (Box 2, p. 2).

Were these conclusions relevant for Africa then? Are they still?

How can infrastructure be managed like a business in settings where governments, despite years of attempted reform, have not become business-like? What changes have been introduced across Africa to induce bureaucrats to surrender (or share) control over key areas of infrastructure (dams, pipelines, telecommunications, fuel refineries, drainage, irrigation, electricity generation and distribution, water treatment and delivery, ports, airports, and railways)?[6] To what extent has increased competition improved efficiency in the provision of infrastructure services? And, how might stakeholders gain a greater voice in circumstances where democratization has been stalled or deflected?

Experience over the last five years has answered some of these questions. There have been successes.[7] For instance, Zambia shut its loss-making national airline with no adverse repercussions. Several airlines quickly filled the gaps with marked improvements in service. There have been failures. In Zambia, despite stakeholder participation, the fuel tax earmarked for road maintenance has been diverted to other uses.

To determine whether the conclusions of the WDR 1994 remain relevant for Africa, other questions need to be answered. Two stand out – the capacity of governments to regulate, and financing of recurrent costs.

The need for regulation is driven by the logic that governments cannot (or should not) withdraw from areas that, by definition, involve spill-over effects without first ensuring that there is a regulatory mechanism to protect the public interest. Large amounts of donor support have been provided for this purpose. Missing from all of this is the question: why bother? Why would governments, having mismanaged infrastructure throughout the years, be any more competent in regulating that activity? What of regulatory capture? Isn't this simply moving from one government failure to another? Indeed, an indication of the problems with this disengagement/regulation model can be readily gauged from the poor performance of privatization agencies that were established around Africa ostensibly to "protect the public interest"[8] while the state divested.

The recurrent cost problem has been widely studied since planners in the Soviet Union in the 1940s first began to notice severe "capital wastage" because of the under-provision of funding for maintenance. Moreover despite large amounts of work since then,[9] there is nothing in WDR 1994 that advances the issue beyond earlier analyses (Club du Sahel 1980; Gray and Martens 1983).

If anything, WDR 1994 is a step backwards. It fails to keep the recurrent cost problem in context.[10] African governments have major backlogs of maintenance expenditure, they continue running large budget deficits, and they remain burdened with external debt that cannot be properly serviced. How will these governments begin to raise the required recurrent and capital resources to respond in ways the WDR 1994 suggests?

One answer might be that the HIPC (highly indebted poor country) initiative will rationalize Africa's external debt easing at least one of these constraints. However, due to the knock-on effects of the Asian situation and continued instability within Africa, many highly indebted countries are increasing their debt. Furthermore, the growth assumptions that would make HIPC a "debt exit" strategy are unrealistic even in the most favorable cases. The implication is that most African countries will be unable to afford the additional resources for recurrent costs or new infrastructure.

The continued debt overhang is a major disincentive for the private sector to invest in infrastructure. Moreover, even before the Asian turbulence, private sector investors were showing little interest in such large-scale investments in Africa (AfDB 1997). It remains an open question under what circumstances private sector confidence will revive in ways that stimulate private investment in infrastructure, and how long this will take.

What, therefore, remains front and center with respect to infrastructure? Governments do not have the capacity to make the investments. After years of under-funded recurrent costs, it is not clear why donors will want to fill the gap. And, with private investors jittery, the hoped-for response through privatization is problematic.

4. Strategic Issues in Trade Policy

The strategic issues are the contribution of trade policy to growth, and African countries can be shifted away from their "aid not trade" orientation to something more constructive.

Based on recent empirical analysis, the key issue in trade policy in Africa hinges on the promotion of growth. With collapsing income and excessive debt, most African countries cannot generate the exports to finance the imports needed to support rapid growth and development. This situation can be improved with the policy changes included in "standard" structural adjustment packages – real devaluation, the removal of import and export licenses, lowering the import duty rates and reducing their variance, and eliminating special exemptions. There is now widespread evidence that these changes can have a major impact on trade.[11] But, even though many African countries have made these changes, policy reversals regularly occur (Rodrik 1997; McCulloch and McPherson, chapter xx, this volume).

To move African countries away from their "aid not trade" orientation, African governments need to formulate *and* begin implementing an "aid exit" strategy. Immediate reductions in aid are unlikely due to the debt overhang and chronic balance of payments deficits. However, by devising such a strategy, African policy makers would begin to understand the types of activities required for their countries to eventually become self-reliant. A further advantage of such a strategy is that it would provide a basis for African governments and donors to break out of "games" through which their mutual over-dependence has undermined growth and development in Africa.

One important outcome of an "aid exit" strategy would be renewed emphasis on government savings. The idea of "government as saver," prominent in the mid-1950s and early 1960s (Meier 1970), was buried when governments began to actively promote development and aid agencies decided that it was easier to provide funding to these governments than insist they raise the resources themselves. Ideas of self-help and mutual aid, central to the success of the Marshall Plan, were buried as well (Bell 1965; Orme 1995). Yet, if African governments are to cease being "wards of the international community" (Krugman 1989:184), and begin to reduce their internal and external debt, they have to save. Since African governments generally cannot or will not raise additional domestic revenue, the only option is for sharp cuts in expenditure.[12] The aid exit strategy would provide guidance on how this could be done. None of this will be easy. But three decades of economic decline have not been easy either.

With governments moving off aid and raising savings, the prospects would be high for a major revival in growth. This, in turn, would lead to a rapid improvement in trade. As demonstrated in chapter xx by McPherson and Rakovski, the fundamental reason that Africa has been "marginalized" over the last three decades in world trade exchange in *not* because of Africa's unwillingness to trade. Rodrik (1997) and others have shown that, on average, Africa trades no less than other regions. Marginalization has occurred primarily because African countries have not grown.

By fostering the savings needed to support economic growth, an "aid exit" strategy would provide the basis for African countries to recapture sources of their former share of world markets. At a minimum, it would prevent them from being further marginalized.

5. Infrastructure, Trade Policy and Growth and Development

With war in Sierra Leone and Angola, Eritrea and Ethiopia disputing an area as barren as the moon, and the mess in Congo, peace has not been "breaking out" across Africa. None of this provides a setting suited to broad-based increases in economic activity.

Nevertheless, some countries might make substantial progress if they were to take advantage of the links between infrastructure and trade. Infrastructure is typically associated with economies of scale and scope (World Bank 1994). The same applies to trade (Meade 1955; Gillis *et al.* 1996). But, since real effective demand per capita has broadly declined across Africa, it is little wonder that returns to infrastructure investment have been so low and Africa's ability to compete internationally has fallen. What Africa has experienced is tantamount to "running Adam Smith in reverse."[13] As markets have contracted, the benefits of specialization have also been lost. Indeed, the economic retrogression has been so extensive that some "patterns of growth" have been reversed.[14]

Under conditions of declining income, infrastructure cannot be effectively expanded nor can trade be increased. In the first case, the decline in real effective demand raises the unit costs of infrastructure investment. In the second, as the division of labor diminishes, the decline in specialization compromises the ability of African enterprises to compete in world markets. Sachs and others have highlighted the problem of Africa's geographical isolation (due to high transport costs) (Sachs and Warner 1995; Bloom and Sachs 1998). A parallel process has been underway. The decline of real demand per capita has reduced the economic supply of land.[15] Thus, in addition to the marginalization of Africa in world trade (Collier 1994; Yeats *et al.* 1997), a process of marginalization of enterprises within Africa itself has occurred as real demand has fallen.

How can this be reversed? One approach would be to use the expansion of trade as a guide for investing in infrastructure. All restrictions on exports would be removed and resources (both recurrent and capital) would be selectively devoted to the infrastructure needed to facilitate exports. This is clearly a strategy for “unbalanced” growth. Any benefit for non-export sectors would accrue through spillovers and linkages. Although few African governments (and perhaps fewer donors) have shown much interest in this approach, shortage of resources (particularly as African governments seek an exit from aid) may make it more attractive. The advantage for many African countries is that since their principal exports are derived from agriculture, an expansion of trade will help raise rural incomes and improve rural infrastructure. The goal of linking trade and infrastructure is to foster sustained increases in demand so that transport, transaction, and intermediation costs[16] can begin to fall providing the basis for further growth.

Removing all restrictions on exports will help stimulate enterprise. Such special measures are needed because the suppression of enterprise has been a major source of economic retrogression. Moreover, for too long both governments and donors have presumed that they understand what is required to get Africa “on the move.” History clearly shows that governments know little about enterprise[17] and donors even less. Neither faces a hard budget constraint. Nor do they face the same down-side risks as private entrepreneurs.

The WDR 1994 (Chapter 5) concluded with the assertion that “finance follows enterprise” (World Bank 1994:108). This has not been the case in Africa. Government and donor finance for infrastructure has preceded enterprise. Furthermore, donors have provided finance to encourage governments to “open up” to trade before the emergence of the enterprise that would allow Africa to compete in world markets. With all this finance provided in advance, what role has there been for enterprise? Why has there been any need for enterprise?

Part of the problem is that there is confusion over what governments and donors can and should do. Experience shows that African governments cannot simultaneously promote economic growth and social welfare. By financing infrastructure ahead of enterprise they have opted for social welfare rather than growth. For their part, donors cannot be charitable and hard-nosed at the same time. By seeking to ease the costs of adjustment for African governments, they have undercut the incentive for those governments to promote reform. Together, both have been a deadly cocktail for the continued erosion of real incomes.

6. Concluding Comments

For infrastructure and trade policy to contribute to making a sustained contribution to growth and development in Africa, markets need to expand. These markets will not materialize on the basis of governments and donors placing infrastructure “front and center” in the development agenda. They will not materialize through trade policy reform conditioned by balance of payments support. They will also not materialize while African governments continue to dis-save and do nothing substantive to break their dependence on aid.

The expansion of infrastructure and trade in Africa will be sustained by enterprise – African entrepreneurs seeking ways of expanding their existing operations or branching into entirely new types of activity. African governments and donors can cooperate to support this. They cannot drive the process.

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Endnotes

[1] The World Development Report 1994 reported a range of evidence showing that growth has both preceded and lagged the expansion of infrastructure. According to Roemer (1996):

> ...infrastructure-led growth is difficult to justify in economic theory; has not been the strategy of choice in any of the rapidly-growing developing or industrial countries since the second world war; and would, if attempted, quickly lead to serious macroeconomic imbalances and market distortions.

By contrast, Rodrik (1997) argued that infrastructure is “fundamental for long-term growth.”

[2] Opinions diverge sharply on the most effective path to long-term growth. For example, Ndulo *et al.* (1996) seek an African “renewal” through improvements in “state capacity.” Ayittey (1998) looks to activism among African intellectuals committed to development. Madavo and Sarbib (1997) highlighted the emergence of “pragmatic, no nonense” leaders.

[3] It is easy to overlook the fact that it took the United States over fifteen years to bring the federal budget into balance. Canada took seven years to implement a value-added tax and then did not “get it right”. The structural adjustment program for Ethiopia includes the implementation of a VAT in two years and the introduction of an income tax on agriculture within three years. These were two of more than 88 separate structural conditions included in Ethiopia’s donor-supported adjustment program.

[4] The study *Adjustment in Africa* (World Bank 1994a) provides details.

[5] The recent African Development Report “Human Capital Development” (AfDB 1998) is a sober assessment of the challenges African countries face in this area.

[6] The study *Bureaucrats in Business* (World Bank 1995) has many compelling reasons why bureaucrats should not be in business. A campaign slogan of the Movement for Multi-Party Democracy party that unseated President Kaunda in Zambia in 1991 was “the government has no business in business.” Ironically, getting government out of business has been one area where the MMD government has been the least successful.

[7] See ADB (1997:Ch.5) and the World Bank *Findings* series.

[8] The activities of Zambia’s Privatization Agency have been praised by the World Bank and African Development Bank, among others (ADB 1997:109). Reviewers have been impressed by numbers of organizations disposed of, overlooking the small value of the assets involved. The most important privatization, namely of the state-owned copper mining company, has been badly handled at a cost (direct and indirect) to the Zambian economy of billions of dollars.

[9] Development specialists wrote about recurrent costs in Senegal in the 1960s, Peter Heller studied the problem for his thesis in the 1970s (Heller 1974, 1979), the CILSS *et al.* sponsored the Sahel Recurrent Cost Study in the late 1970s and early 1980s (CILSS *et al.*1980), and the World Bank has examined its critical nature in activities such as road maintenance (World Bank 1988).

[10] The WDR 1994, however, does make one interesting observation (*loc.cit.*108):

> In important respects, the traditional style of infrastructure financing has been too easy.

Based on this admission, no one should be particularly surprised that returns are low and wastage high.

[11] Block (1998) has shown that trade distortions have had a high cost in terms of foregone growth in Africa.

[12] This is part of the strategy advocated in HIID (1997).

[13] To understand the dynamics of this process, one only has to read some of the "new growth" literature or Solow's (1997) recent exposition of Arrow's model of "learning by doing" and imagine what the process looks like in reverse. Without too much effort, endogenous sources of decline and dissipation emerge. These can be modeled mathematically (McPherson and Zinnes 1991).

[14] The patterns are given in Chenery and Syrquin (1975) and Syrquin and Chenery (1989). Counterexamples are given in McPherson and Zinnes (1991). The most common inverse pattern has been the increasing share of agriculture in GDP. The WDR 1994 gives 12 examples. Over the period 1970 to 1992, agriculture's share in output increased in Tanzania, Sierra Leone, Madagascar, Burkina Faso, Togo, Benin, Central African Republic, Ghana, Somalia, Zambia, and Algeria. Mauritania showed no change over the period. (World Bank 1994: Table 3, pp.166-7). The only two countries outside Africa where the ratio increased were Nicaragua and Myanmar.

[15] T.W. Schultz (1957) made the distinction between the economic and physical supply of land. The former was the area that, given current market conditions and state of technology, would support activities that earned a positive net rent. As the demand curve shifts inwards, rents decline.

[16] These have all been identified as key elements in the process of development (McKinnon 1973; North 1997).

[17] The WDR 1994 is explicit (*loc.cit.:*7):

> Governments – by confusing their roles as owners, regulator, and operator – have failed to improve service delivery.